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IN THE

Supreme Court of the United States

OCTOBER TERM 1941

No. 359.

CHINESE CONSOLIDATED BENEVOLENT ASSOCIATION, INC.,
Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

WILLIAM M. CHADBOURNE,
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GERALD B. O'NEILL,
HENRY B. HYDE,
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CHINESE CONSOLIDATED BENEVOLENT ASSOCIATION, INC., Petitioner, against SECURITIES AND EXCHANGE COMMISSION, Respondent.	No.....

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Chief Justice of the United States and Associate Justices of the Supreme Court of the United States:

The petition of Chinese Consolidated Benevolent Association, Inc., respectfully shows to this Honorable Court:

A

Summary Statement of the Matter Involved.

The facts in this case are undisputed, all facts alleged in the complaint having been admitted by the answer, and the complaint being based upon an agreed statement of facts entered into by stipulation between counsel for the parties hereto. The defendant is a New York charitable organization, its objects, as set forth in its Certificate of Incorporation, being "to ameliorate the condition of the

Chinese poor in and about the City of New York * * * and generally to aid and succor all worthy Chinese who may be found to be in need of assistance."

On September 1, 1937, the Government of the Republic of China authorized the issuance of $560,000,000 principal amount of bonds, known as "Liberty Bonds", and later, in May, 1938, authorized the issuance of $50,000,000 principal amount of 5% United States Dollar Bonds, known as "Dollar Bonds". No registration statement pursuant to the Securities Act of 1933 as to these bonds has been in effect.

In October, 1937, the defendant organized a committee known as the General Relief Fund Committee (hereinafter referred to as the "Committee"), "for the purposes of uniting the Chinese community and the various organizations and societies thereof in aiding the Chinese people * * * and to solicit and receive funds from members of the Chinese communities in New York, New Jersey and Connecticut for transmittal to China for general relief purposes". The members of the Committee reside in the City of New York, are leaders in the Chinese community and serve voluntarily, having at no time received or expected to receive compensation for their services. Neither the Committee nor any of its members has any official or contractual connection with the Government of China or any branch thereof.

The Committee has from time to time held mass meetings at which information has been given out as to conditions in China and has made reports as to the results accomplished by it. Through the medium of such mass meetings, by personal appeals and by means of newspaper advertisements, the Committee has urged members of Chinese communities in New York and in the vicinity to purchase the bonds issued by the Chinese Republic.

In some instances, at the request of and for the convenience of prospective purchasers of the bonds, the Committee has received funds from prospective purchasers, has delivered all of such funds to the New York Agency of the Bank of China (hereinafter referred to as the "Bank"),

for the purchase either of the "Liberty" or the "Dollar Bonds" for the account of the prospective purchasers, and has delivered a receipt for the funds so received to the person from whom it received them. In all cases in which it has received funds the Committee has filed applications in the name and on behalf of prospective purchasers for the purchase of the bonds and has obtained receipts for the funds delivered to the Bank. The Committee has acted as an agent for the prospective purchasers only to the extent of delivering funds received by them to the Bank. Upon receipt of applications, either made personally or by the Committee for prospective purchasers, the Bank has transmitted the funds received by it to its agency in China with instructions to purchase the bonds for the account of the prospective purchasers.

Upon receipt of the bonds, the Bank has delivered them to the individual purchaser in accordance with his name and address appearing on the Bank's receipt. The Bank acts solely as an agent and makes no solicitation of the purchase of bonds or for the business involved in transmitting the money for the purchase thereof. No charge is made by the Committee for its services in connection with receiving funds to be used for the purchase of bonds and all such funds are delivered by it to the Bank for remittance to China. The members of the Committee receive no compensation, either from the persons who transmit money or from the Bank or from the Government of China or any department or agency thereof, or from any other source in connection with its activities.

In this action, the Securities and Exchange Commission sought to enjoin the defendant from alleged violation of Section 5(a) of the Securities Act of 1933 through the course of conduct by the defendant, outlined above. This case came before the District Court for the Southern District of New York where both plaintiff and defendant moved for judgment on the pleadings. A written opinion was handed down granting the motion of the defendant and denying the motion of the plaintiff. An appeal was taken

to the Circuit Court of Appeals for the Second Circuit where the decree below was reversed by a divided court, with directions to the District Court to deny the defendant's motion to dismiss and to issue the injunction as prayed for in the bill of complaint. Swan, J., dissented in a written opinion.

B

Reasons Relied On for the Allowance of the Writ.

1. The Circuit Court of Appeals in holding that the defendant has violated Section 5(a) of the Securities Act, because, as the Court found, it engaged in selling non-registered securities issued by the Chinese Government and because, as the Court found, it solicited offers to buy the securities "for value", has decided an important question of general law in a way probably untenable or in conflict with the weight of authority.

2. The Circuit Court of Appeals in holding that the defendant has violated Section 5(a) of the Securities Act, because, as the Court found, it engaged in selling non-registered securities issued by the Chinese Government and because, as the Court found, it solicited offers to buy the securities "for value", has decided an important question of Federal law which has not been but should be settled by this Court.

3. The Circuit Court of Appeals in holding that, as the Court found, the defendant has violated Section 5(a) of the Securities Act, because, as the Court found, it engaged in selling non-registered securities issued by the Chinese Government and because, as the Court found, it solicited offers to buy the securities "for value", has decided a Federal question in a way probably in conflict with applicable decisions of this Court.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record in the cause above entitled, and that the said decree of the United States Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

CHINESE CONSOLIDATED BENEVOLENT ASSOCIATION, INC.

By WILLIAM M. CHADBOURNE,
Counsel for Petitioner.

IN THE

Supreme Court of the United States

OCTOBER TERM 1941

CHINESE CONSOLIDATED BENEVOLENT ASSOCIATION, INC., Petitioner, against SECURITIES AND EXCHANGE COMMISSION, Respondent.	No.....

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

Opinions of the Courts Below.

The opinion of the District Court is found in the record at pages 30-38.

The majority opinion of the Circuit Court of Appeals (per Augustus Hand, J.) appears in the record at pages 46-52. It has not been reported, having been handed down in the Circuit Court of Appeals for the Second Circuit on June 6, 1941.

The dissenting opinion of Swan, J., in the Circuit Court of Appeals appears in the record at pages 52-53.

II

Jurisdiction.

The decree of the Circuit Court of Appeals for the Second circuit, sought to be reviewed, was filed on June 23, 1941.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as last amended by the Act of June 7, 1934, Chapter 426, 48 Stat. 926; 28 U. S. C. A., Section 347(a).

III

Statement of the Case.

A full statement of the case has been given under the heading "A" in the attached petition and, in the interest of brevity, is not repeated at this point.

IV

Specifications of Errors.

I. The Circuit Court of Appeals erred in finding that defendant has violated Section 5(a) of the Securities Act of 1933.

II. The Circuit Court of Appeals erred in finding that defendant engaged in selling unregistered securities issued by the Chinese Government.

III. The Circuit Court of Appeal erred in finding that defendant solicited offers to buy the securities "for value".

IV. The Circuit Court of Appeals erred in finding that the alleged solicitation of defendant "broadly speaking was for the issuer in connection with the distribution of the bonds".

V. The Circuit Court of Appeals erred in finding that defendant acted as "an underwriter".

VI. The Circuit Court of Appeals erred in reversing the decree of the District Court with directions to deny the defendant's motion to dismiss and to issue the injunction as prayed for in the bill of complaint.

V

Argument.

SUMMARY.

POINT I. The decision of the Circuit Court of Appeals, that the defendant is an underwriter, within the meaning of that term as defined in the Securities Act of 1933, is contrary to the plain words used in the Act, and to the construction thereof by the Courts and the Commission.

POINT II. The construction placed upon the Securities Act of 1933 by the majority of the Circuit Court of Appeals is erroneous.

POINT III. Should the Commission be entitled to relief, resort should be had to diplomatic intervention, rather than to the injunctive process.

POINT I

The decision of the Circuit Court of Appeals, that the defendant is an "underwriter", within the meaning of that term as defined in the Securities Act of 1933, is contrary to the plain words used in the Act, and to the construction thereof by the Courts and the Commission.

We deem it desirable to point out to the Court certain fundamental considerations which we believe the Court should have in mind in considering the question presented by this petition.

First, *there is and can be nothing to prevent the Chinese Government from selling the bonds in China.** In this case all bonds are sold in China.

Second, *no individual is or can be prohibited from purchasing bonds from the Chinese Government in China.* The facts in the instant case clearly show that all purchases of bonds are made in China by agents of the individual purchasers.

Third, *neither the defendant nor the Committee is an agent in this country of the Chinese Government.*

Fourth, the activities of the Committee in urging others to buy the bonds are entirely distinct from its activities as agent for prospective purchasers and must be so considered. These activities must not be confused.

Fifth, all sales of bonds take place in China.

Sixth, the majority of the Circuit Court of Appeals have apparently misapprehended just what facts were contained in the agreed statement of facts entered into between counsel for the parties. In the majority opinion reliance was placed upon the erroneously assumed fact that five separate consent injunctions were obtained against other Chinese benevolent associations, under similar circumstances. This, said the Court, showed "a broad acquiescence in the Commission's interpretation of the Statute" (R. 53). There is nothing in the record to indicate that five consent injunctions were obtained against other Chinese benevolent associations nor is there any evidence as to the facts and circumstances under which the decrees were consented to. What is more, the facts and circumstances in those cases were entirely different and bear no resemblance to those in the present case.

Inasmuch as these cases were never made part of the agreed statement of facts, counsel for the petitioner were much surprised that the attorneys for the Commission re-

* Throughout the argument, whatever italics there are, are those of the petitioner, unless otherwise indicated.

ferred thereto in their brief. In view of the importance which the Circuit Court of Appeals attached to the finding, that there had been "a broad acquiescence in the Commission's interpretation of the Statute", we venture to stress to this Court this serious error.

In this action the Commission sought to enjoin the defendant from certain acts and practices which are alleged to violate Section 5(a) of the Act, which reads as follows:

> "Sec. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
>
> "(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or
>
> "(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale."

This section does not apply to all transactions in unregistered securities. Certain types of transactions are specifically exempted from the prohibitions of this section by Section 4(1), which provides in part as follows:

> "Section 4. The provisions of Section 5 shall not apply to any of the following transactions:
>
> "(1) Transactions by any person other than an issuer, underwriter or dealer;"

Since it is not claimed that defendant is either an issuer or a dealer and since, in fact, it is neither (R. 35), unless defendant is an "underwriter", the provisions of Section 5(a) are not applicable to it and the action must fail.

Used in its technical sense, the term "underwriter" was, prior to the adoption of the Act, defined to mean one who for a commission undertook to see that an issue of se-

curities was disposed of to the public at a price and to purchase such part of the issue as might not be taken by the public. As used in a popular sense, the term was also defined loosely to mean one who purchased all of an issue of securities and resold it for his own account to the public. In the technical sense, the underwriter acted under a contract or agreement with the issuer; in the popular sense, the underwriter purchased for himself and marketed the securities for his own account. In either sense, the term implied certain relationships between the underwriter and the issuer.

In the definition of the term which is contained in Section 2(11) of the Act, both the technical and popular definitions have been included. This section, insofar as it is material to the issue here, reads as follows:

> "The term 'underwriter' means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking."

It is clear in the present case that defendant has not "purchased from an issuer, with a view to, * * * the distribution of any security"; that is, defendant is not an underwriter in the popular sense of the term (R. 35). Nor can there be any contention that it is a person who "participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking".

Accordingly, the only question here involved is whether defendant "*sells for an issuer* in connection with, the distribution of any security"; i.e., is an underwriter in the technical sense. The determination of this question depends in turn on the determination of the questions (1) whether defendant "sells", and (2) if so, whether it "sells for an issuer".

A. Defendant's activities do not constitute "sales".

It must be clearly apparent that under any ordinary definition of the word "sell" defendant's activities do not constitute sales.

The term "sell" has been defined in Section 2(3) of the Act as follows:

> "The term 'sale', 'offer to sell', or 'offer for sale' shall include every contract of sale or disposition of, attempt or offer to dispose of, or *solicitation of an offer to buy,* a security or interest in a security, for value; except that such terms shall not include preliminary negotiations or agreements between an issuer and any underwriter."

The only portion of the foregoing definition that can have any application here is the clause "solicitation of an offer to buy". A mere reading of the definition in connection with the facts of the case should be enough to demonstrate that no other provisions of this section could under any circumstances be applicable.

In the first place, defendant does not "attempt or offer to dispose of * * * a security", because it has no security to dispose of either by ownership or by the existence of any relationship with the issuer which would permit it to make such disposition.

In the second place, defendant does not contract to sell or dispose of a security (R. 35). As the learned District Court says in its opinion (R. 36):

> "The words 'attempt or offer to dispose of' a security connotes authority from the issuer to consummate the transaction, and in an effort to bring the defendant within that phase of the definition set forth in Section 2(3) of the Act the Commission begs the question in its reply brief."

Its activities in urging purchasers to buy the bonds are purely voluntary on its part and made only on its own initiative. It is not an agent either of the Government or

of the respective purchasers in so urging. In delivering funds to the Bank for individual purchasers, defendant merely acts as the former's intermediary, doing for the former what they could unquestionably do for themselves without in any way violating the Act.

Do defendant's activities involve "a solicitation of an offer to buy"?

Although at first blush one might perhaps answer "yes", since it is undisputed that defendant urges all Chinese to buy the bonds, that is, asks them to make an offer to buy them, a careful analysis shows that it was never contemplated that the Act should be so broadly applied. The definition of the term "sale" is discussed in H. R. Rep. No. 85 (73rd Congress, 1st Session) where it is pointed out what practices the words "solicitation of an offer to buy" were intended to cover—namely, the preventing of dealers from making offers to buy, between the filing of the registration statement and its effective date.

> "The term 'sale' or 'sell' is defined broadly to include every attempt or offer to dispose of a security for value. It includes within the definition of 'sale' an offer to buy, *thereby preventing dealers from making offers to buy between the period of the filing of the registration statement and the date upon which such a statement becomes effective.* Otherwise, the underwriter, although only entitled to accept such offers to buy, after the effective date of the registration statement, could accept them in the order of their priority and thus bring pressure upon dealers, who wish to avail themselves of a particular security offering, to rush their orders to buy without adequate consideration of the nature of the security being offered."

In discussing Section 5 of the Act with respect to activities of underwriters and dealers during the twenty-day waiting period, the Federal Trade Commission, the Commission's predecessor, in Securities Act of 1933, Release No. 70, November 6, 1933, referred to the foregoing report

and confirmed its interpretation of the meaning of the Act, saying:

> "This period, says the House Report, contemplates a change from methods of distribution lately in vogue which attempted complete sale of an issue sometimes within one or at most a few days. Such methods practically compelled distributors, dealers, and even salesmen as the price of participation in future issues of the underwriting house involved, to make commitments blindly.
>
> "During the waiting period, as well as prior thereto, Section 5 of the Securities Act makes it unlawful for the issuers, underwriters, and dealers (to whose transactions the Act is generally applicable) to make an offer to buy or to sell a security—always remembering that 'sell' carries within it the conception expressed in Section 2(3) of an offer to sell or a solicitation to buy. The same section also makes it unlawful to transmit any prospectus (the central feature of which under Section 2(10) is the fact that it offers a security for sale) relating to a security during this period prior to the effective date of a registration statement. The purposes of these sections as related to this particular problem are obvious. *Dealers are not to be solicited to buy the security until a registration statement is in effect;* nor are they to offer to buy such security—an injunction made necessary by the fact that otherwise priority of application during the waiting period might be made the basis for priority of allotment."

From these two statements it is perfectly clear that the clause "solicitation of an offer to buy" in the definition of the word "sell", was included solely for the purpose of preventing the circumvention of the twenty-day waiting period provided by the Act, by the establishment of priorities by an underwriter based upon orders obtained by it from, or submitted by, dealers prior to the expiration of such period.

The conclusion is inescapable that defendant's activities do not constitute *solicitations of offers* to buy within the meaning of the Act.

B. Defendant is not selling "for an issuer".

If it is assumed for the purpose of argument that defendant's activities in urging others to buy the bonds constitute "sales", defendant is an underwriter only if it sells the bonds "for an issuer".

It seems clear that the use of the phrase "for an issuer" in conjunction with the word "sells" indicates the intention of Congress by this definition to define as an "underwriter" a person who comes within the meaning of that term as it was technically defined prior to the adoption of the Act; that is, that an underwriter is one who contracted with an issuer to sell to the public its securities and to take up such balance as might not be sold to the public. This is even more clear when it is realized that the clause now under consideration is the correlative of a clause defining as underwriters those who prior to the adoption of the Act came within the popular definition; that is, persons who have purchased "from an issuer with a view to, * * * the distribution of any security".

Only those who "sell *for an issuer*" are underwriters.

Accordingly, as used in the Act, the term "underwriter" involves the existence of a contractual or agency relationship between the issuer and the person alleged to be an underwriter. To hold otherwise would negative the existence of any exemption under Section 4(1).

The Commission has recognized that such a relationship must exist. In *Matter of Canusa Gold Mines, Limited*, Securities Act of 1933, Release No. 1507, July 15, 1937, the Commission held that an issuer was liable under Section 12(1) of the Act in connection with the sale of its stock prior to the filing of a registration statement therefor, on the ground that a certain firm of brokers which sold such stock was an underwriter thereof. It appeared that directors and principal stockholders of the issuer loaned their stock to the brokers under an arrangement providing for the sale thereof to the public and the remission to the issuer of 25¢ per share from the proceeds of such sale.

The Commission discussed the evidence at length and held that it had been established that such transaction had taken place with full knowledge of the issuer and as part of an arrangement between the issuer, its stockholders and the brokers. The Commission held that the stock was sold "for" the issuer, that the brokers were in fact agents of the issuer and hence that they were underwriters of the stock. The Commission said:

> "An 'underwriter' is defined by Section 2(11) of the Securities Act of 1933 as 'any person who * * * sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking * * *.' It is clear that the sales by Outlook Investments, Ltd. of stock loaned to it by the officers, directors and stockholders of the registrant pursuant to a tripartite understanding between these persons, the underwriter and the issuer constituted sales 'for' the issuer, Canusa Gold Mines Limited, in connection with the distribution of its stock. The fact that 25¢ per share of the proceeds of all such sales was paid direct to the registrant or applied to its account is conclusive that Outlook Investments, Ltd. was acting for the registrant in selling the loaned shares. Therefore, there can be no question that this distribution of the borrowed stock through the mails and in interstate commerce was effected by Outlook Investments, Ltd. *as an agent for the registrant* and *hence with respect to these borrowed shares it was an 'underwriter' as defined in the Act.* Unless some exemption under Section 3 of the Act is applicable to the securities sold, all transactions by an underwriter are subject to the registration requirements of Section 5(a) of the Securities Act. No such exemption is claimed in this case. Accordingly, all sales thus made by Outlook Investments, Ltd., directly and indirectly, through the mails or by the use of instrumentalities of interstate or foreign commerce seem to have been in direct violation of Section 5(a)(1) of the Act. Likewise the delivery of shares through these means for the purpose of sales or after sale would appear to have violated Section 5(a)(2). These transactions accordingly resulted in civil liabilities

> under Section 12(1) of the Act. Since these sales were effected for the benefit of, and under an arrangement with, the issuer who received 25¢ per share sold, it is our opinion that the civil liabilities thus created may extend to the issuer."

This states the law as we believe it to be, namely, that to be an underwriter one must act "for an issuer"; that is, as an agent of the issuer.

In the present case, defendant has no contractual or agency or other relation with the Chinese Government or any of its agencies (R. 35).

The fact that defendant assists prospective purchasers of the bonds by taking funds to the bank and executing applications for the purchase of bonds does not change defendant's status in any way. This the Commission conceded. It is doing merely what such purchasers could unquestionably do themselves without coming within the prohibitions of the Act.

Since defendant is not an underwriter, it has the right of any individual to express its opinion concerning, and to urge the purchase of, the bonds. Congress never intended the result for which the Commission contends, namely, that a person who neither has any connection with an issuer nor sells for his own account is nevertheless an underwriter because such person urges others to purchase from the issuer the latter's securities.

The Act clearly was intended to apply to persons who are "underwriters" as that term was defined either technically or popularly at the time of the adoption of the Act. Defendant is not an underwriter under that definition or under the definition contained in the Act. To find defendant is an underwriter emasculates the exemptions provided in Section 4(1).

POINT II

The construction placed upon the Securities Act of 1933 by the majority of the Circuit Court of Appeals is erroneous.

By considering its language and the decisions under it we have shown above that the Securities Act cannot be held to apply to the activities of the defendant. We now turn to the construction put upon the statute by the Court below.

The first ground for the holding of the majority opinion of the Circuit Court of Appeals recognizes that if defendant is not an "underwriter", then Section 4 of the Securities Act exempts the actions of defendant (R. 50). Looking to the definition of "underwriter" in Section 2(11) that we have already discussed, the Court concedes that the only words which are susceptible of covering the actions of the defendant are "any person who * * * sells for an issuer in connection with the distribution of any security". Although the Court can state no authority contrary to the position the Commission itself took in *Matter of Canusa Gold Mines, Limited*, supra, that the words "for an issuer" mean acting *as an agent of the issuer*, it goes on to hold that "sell for an issuer * * * ought to be read as covering continual solicitation, such as the defendant was engaged in." This is not only plainly against the ordinary meaning of the words used and contrary to the position of the Commission itself, but as was said by Judge Swan in his dissenting opinion in the Circuit Court of Appeals, "gives no meaning to the words *for an issuer*". Judge Swan goes on to show the lengths to which this construction of the majority opinion will lead by pointing out that "a single newspaper editorial, published without instigation by the Chinese Government and merely urging the purchase of the bonds in the name of patriotism, would make the

newspaper an 'underwriter'." (R. 52-53). That Congress could have intended such a result is scarcely conceivable.

As was said in *Wight* v. *Heublein*, 238 Fed. Rep. 321 (C. C. A., 4th Cir.):

> "There are few surer tests in statutory construction than to observe whether the interpretation contended for exposes the statute itself to ridicule; and to find in this act a requirement that * * * is absurdity itself, and the argument must go to this extent."

The other ground relied upon by the majority of the Circuit Court of Appeals (R. 51) is equally unwarranted by the provisions of the Securities Act. At the beginning of its opinion on this point, the Court held that "Section 4(1) was intended to exempt only trading transactions between individual investors with relation to securities already issued and *not to exempt distributions by issuers*". No authority is cited for this proposition either from decisions or from Congressional Reports and it is altogether unjustified on the face of the words used in that section of the Act or elsewhere. A little further on there appears the statement "even if the defendant is not an issuer, underwriter or dealer", it was participating in a transaction with an issuer, to wit, the Chinese Government. However that may be, Section 4(1) does not exempt from the provisions of the Act

> "transactions by any person other than an issuer, *or one participating in a transaction with an* issuer, an underwriter or dealer."

It has never been a rule of statutory construction to graft on a whole group of words to broaden a plain meaning of a statute.

Finally, the Court goes on to hold that the activities of defendant in connection with the offers to buy the bonds by the Chinese in the United States were only a part "of the complete transaction" which included the offers them-

selves, the transmission of the offers to China, their acceptance and the transmission of the bonds to the purchasers. This is true enough, just as every human act can be broken down into the mental impulse that directs the muscular action and the muscular contraction which carries out the commands of the mind, but not so the conclusion that the Court derives from this fact, namely, that Section 4(1) "does not in terms or by fair implication protect those who are engaged in steps necessary to the distribution of security issues". That is to say, Section 4(1), it was held, does not apply to exempt component parts of the entire issuing transaction, which component parts are consequently included in transactions by issuers, underwriters and dealers.

The fallacy in this position lies in the fact that the issuer, the underwriter and the dealer are themselves cogs in the chain of issuing and delivering securities to the particular purchaser and since the statute provides that these specific cogs are not exempt, then surely along the old rule of statutory construction "inclusio unius exclusio alterius", other participants in the issuing transaction are exempt. It would have been easy enough for Congress to have provided words to cover other participants in the issuing transaction had it seen fit to do so, so that Section 4(1) would have exempted

> "transactions by any person other than an issuer, underwriter or dealer, *and other persons involved in the process of issuing securities*".

And why indeed would Congress have provided for any exempted transactions *at all* had it not intended to have only certain participants in the whole span of issuing securities bound by the provisions of the Act. Here again, there is no authority in the words of Section 4(1) nor in any court decision or the Congressional Reports to suggest in any way this construction, which does violence to the plain meaning of the words used in the Act, and to the plain scheme of the statute.

The holdings of the majority opinion in the Circuit Court of Appeals can only be based upon the unjustifiable idea of giving an elastic construction to the language of an Act, which the Court apparently believed Congress made intentionally broad in view of the importance of regulating the sale of securities. However that may be, "the provisions of the Act are clear and free from ambiguity" (R. 38) and the Securities Act can no more be broadened in its scope, and its plain language departed from, than any other Act of Congress. It is supererogatory to point out that it is not and never has been proper for the courts to usurp the function of the legislators, with the purpose of reaching even the most allegedly desirable results, and that whenever lower courts have attempted to do so, this Court has prevented these attempts, pursuant to the basic division of functions between the legislative and the judicial branches of the government.

As was said in *Iselin* v. *United States*, 270 U. S. 245:

> "What the [Commission] asks is not a construction of a statute but in effect an enlargement of it by the Court * * *. *To supply omissions transcends the judicial function.*" (*United States* v. *Detroit First National Bank*, 234 U. S. 245.)

If a particular course of conduct requires regulating in the eyes of the Securities and Exchange Commission, it is for the Commission to address itself to Congress for the power to do so. It is not for the courts arbitrarily to confer that power upon it, by distorting the plain meaning of words in an Act of Congress. It is the duty of Congress, which it cannot delegate, to determine policies and regulate the rules and regulations which administrative bodies must follow. Art. 1, Secs. 1 and 7, U. S. Constitution; *Schechter* v. *United States*, 295 U. S. 495, at 530. The provisions of the Act are clear and unambiguous. Transactions by all persons except issuers, underwriters and dealers are excluded from its scope. The further

limitation of the exemptions provided in Section 4(1) completely emasculates that section, and pushes the statute to cover situations which we have shown could not possibly have been intended by Congress to be thus regulated.

POINT III

Should the Commission be entitled to relief, resort should be had to diplomatic intervention, rather than to the injunctive process.

Even assuming that the Act could be held applicable in this situation, it is obvious that the ordinary rules of International Law as developed by the courts of this country should be applied in this situation, namely, that injunction or other relief cannot be granted against a foreign government and that the proper procedure would be as indicated in the opinion of the District Court, when it says (R. 37) "the channels of diplomacy are open through the Department of State".

The Chinese Government is represented in this country, and its authorized representative should be requested, if necessary, to file a registration statement. As was said in the opinion of the District Court, "no attempted backdoor entrance to the [Courts] can be permitted to compel such a result" (R. 38).

CONCLUSION

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers in order that the errors into which the Circuit Court of Appeals for the Second Circuit has fallen may be corrected and substantial justice be done and that to such an end a writ of certiorari should be granted and this Court should review the decision of the Circuit Court of Appeals for the Second Circuit and finally reverse it.

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GERALD B. O'NEILL,
HENRY B. HYDE,
of Counsel.

August 4, 1941.

No. 359

In the Supreme Court of the United States

OCTOBER TERM, 1941

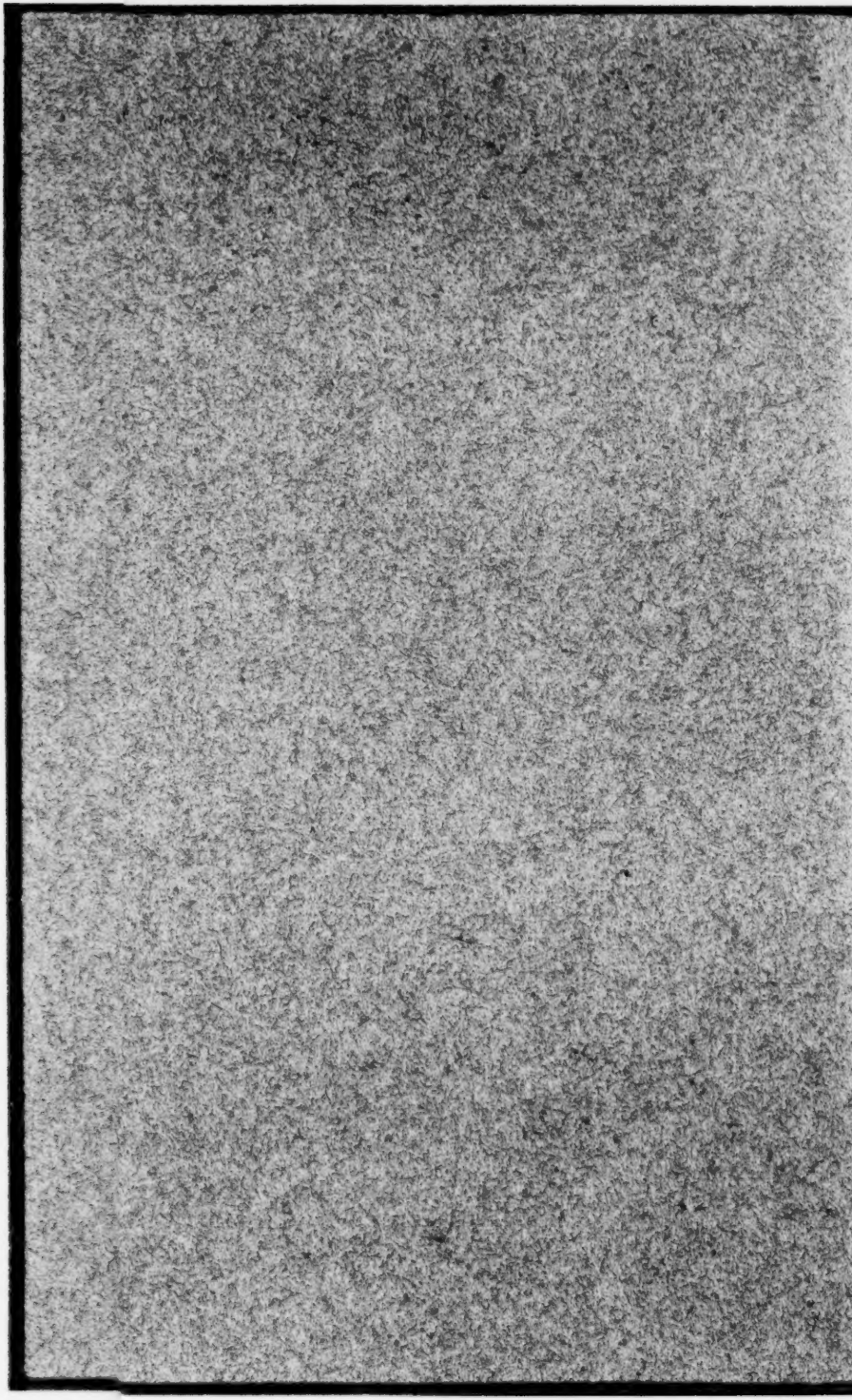
CHITTENDEN CONSOLIDATED IRRIGATION ASSOCIATION, INC., PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION



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In the Supreme Court of the United States

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No. 359

CHINESE CONSOLIDATED BENEVOLENT ASSOCIATION, INC., PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 30–38) is reported in 39 F. Supp. 85.

The opinion of the Circuit Court of Appeals for the Second Circuit (R. 46–53) is reported in 120 F. (2d) 738.

JURISDICTION

The decree of the Circuit Court of Appeals was filed on June 23, 1941 (R. 53). The petition for

a writ of certiorari was filed on August 8, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner has engaged in the "sale" of a security within the meaning of Section 5 (a) of the Securities Act of 1933, as amended, and, if so, whether the sale is exempt under the provisions of Section 4 (1).

STATUTE INVOLVED

The pertinent provisions of the Securities Act of 1933, as amended, are found in the Appendix.

STATEMENT

This case was decided by the District Court upon cross motions for judgment on the pleadings (R. 27, 28). The facts set forth in the complaint (R. 4–25), admitted in the answer (R. 26), may be summarized as follows:

On September 1, 1937, the Government of the Republic of China authorized the issuance of $500,000,000 principal amount of bonds known as "4% Liberty Bonds of the Twenty-sixth Year of the Republic of China" (hereinafter referred to as "Liberty Bonds"), and on May 1, 1938, that Government authorized the issuance of $50,000,000 principal amount of "5% United States Dollar

Bonds" (hereinafter referred to as "U. S. Dollar Bonds") (R. 5).

Petitioner is a New York corporation with a membership of approximately 25,000 Chinese (R. 5). On October 8, 1937, just one month after the authorization of the Liberty Bonds, the petitioner organized a committee known as the General Relief Fund Committee (hereinafter referred to as the "Committee"). The purposes for which this Committee was formed include "aiding * * * the Government of China" and "to solicit and receive funds * * * for transmittal to China for general relief purposes" (R. 6).

By means of advertisements inserted in newspapers which were sent through the mails, as well as by mass meetings and personal appeals, the Committee has urged the members of Chinese communities in New York, New Jersey, and Connecticut to purchase Chinese Liberty Bonds and Chinese U. S. Dollar Bonds and has offered to accept funds for the purchase of bonds from the individuals with whom it has communicated (R. 6–7).

As a result of its activities, the Committee has received a sum in excess of $600,000 to be used for the purchase of Liberty Bonds and U. S. Dollar Bonds (R. 7). The funds collected have been delivered to the New York Agency of the Bank of China, which transmits them through the mails to a branch of the bank in Hong Kong, China, with instructions to purchase the bonds. The bonds are

returned through the mails to the bank in New York, which in turn sends them through the mails to the purchasers (R. 7–8). In some cases, the bonds have been mailed to the purchasers in care of the petitioner (R. 8). No charge is made by the Committee for its services in connection with the receipt and transmittal of funds to be used for the purchase of bonds, nor do the members of the Committee receive compensation from any other source in connection with its activities (R. 8–9). The Committee and its members have no official or contractual connection with the Republic of China or any branch thereof (R. 6).

No registration statement under the Securities Act has ever been in effect for either the Liberty Bonds or the U. S. Dollar Bonds (R. 5). Despite this fact, the petitioner has used the mails and the instruments of interstate and foreign commerce, or has caused those means to be used, in soliciting purchases of the bonds, in the transmittal of funds to China, and in delivering the securities after sale to residents of the United States (R. 7–8).

The present suit was commenced by the Securities and Exchange Commission on June 12, 1940 by the filing of a complaint seeking an injunction restraining petitioner from using the mails or any means or instruments of interstate commerce to carry on its activities in connection with the Chinese bonds without registration (R. 10). On cross motions for judgment on the pleadings, the District Court dismissed the complaint (R. 3–4).

The court below reversed (R. 53), one judge dissenting (R. 52–53).

ARGUMENT

The decision of the court below is not in conflict with any decision of this Court or of any other circuit court of appeals and presents no question calling for review by this Court. Although the applicability of important provisions of the Securities Act of 1933 is in issue, these provisions were, we believe, correctly construed by the court below.

1. There can be little question that the petitioner's activities constituted a violation of Section 5 (a) of the Act, unless they are excluded from the operation of Section 5 (a) by the provisions of Section 4 (1). Section 5 (a) provides that it shall be unlawful for any person, including a corporation such as petitioner and a foreign government such as the Republic of China (Section 2 (2)), to use the mails or any instrument of interstate commerce for the sale, or delivery after sale, of a security unless a registration statement as to that security is in effect. Here there was admittedly a use of the mails and the instruments of interstate commerce in connection with a security as to which no registration statement was in effect. The only question raised in this connection is whether petitioner's activities involved a "sale" or a "delivery after sale."

With respect to that question Section 2 (3) of the Act is decisive. It provides that the term "'sale' * * * shall include every * * *

attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value * * *."[1] The admitted fact is that petitioner urged residents of the United States to purchase bonds of the Chinese Government, offering its services as agent for the purchasers in the consummation of the sale. This activity plainly constituted a "solicitation of an offer to buy a security" within the meaning of Section 2 (3).[2]

The fact that petitioner acted as agent for the purchasers in transmitting the funds it collected does not alter the character of its action in soliciting offers to buy. Clearly petitioner did not act as agent for the prospective purchasers when it first approached them; yet it was at that time that petitioner solicited the offers to buy and thereby

---

[1] It is clear that Congress intended by this definition to ascribe to the word "sale" a broader connotation than that ascribed to it in common usage. The House Report on the bill which became the Securities Act of 1933 stated: "Paragraph (3) defines the term 'sale' or 'sell' broadly to include every attempt or offer to dispose of a security for value." H. Rpt. No. 85, 73d Cong., 1st sess., page 11.

[2] Petitioner contends (Pet. 14–15) that the only purpose of including "solicitation of an offer to buy" within the statutory definition of "sale" was to prevent dealers from making offers to buy securities between the filing of the registration statement and its effective date. This contention, of course, has no warrant whatever in the statutory language. The statement quoted from H. Rpt. No. 85, 73d Cong., 1st sess., in support of the contention dealt with language which was not retained in the statute as enacted and which is not in the definition of "sale" in the Act as it now stands.

engaged in "selling" within the meaning of the Act. It was only after the solicitation was made—and Section 5 (a) thereby violated—that petitioner did anything on behalf of the purchasers.

2. Petitioner's activities are not exempted from the operation of Section 5 (a) by the provisions of Section 4 (1). Section 4 (1) provides as follows:

> The provisions of section 5 shall not apply to any of the following transactions:
>
> (1) Transactions by any person other than an issuer, underwriter, or dealer; * * *

This section is inapplicable to the activities of the petitioner for two reason: (a) because petitioner's activities constitute an integral part of a transaction by an issuer; and (b) because petitioner is itself in the position of an "underwriter" as defined by the Act.

(a) In its petition, petitioner treats Section 4 (1) as though it exempted from the provisions of Section 5 (a) all activities of any person other than an issuer, underwriter, or dealer. This is not, however, what Section 4 (1) either states or means. The exemption is limited to "transactions" by any person other than an issuer, underwriter, or dealer. It thus leaves subject to the Act all activities, no matter by whom carried out, which are part of a transaction of sale by an issuer. The exemption applies only when the activities are not part of such a transaction, as, for example, ordinary trading transactions between individual investors.

Petitioner's construction of Section 4 (1) is clearly contrary to the Congressional purpose. The aim of the Act as a whole is to require disclosure of material facts concerning securities when they are the subject of distribution by an issuer or controlling stockholder; it imposes no registration requirement when the securities are the subject of ordinary sales between individual investors.[3] Section 4 (1) draws the line of distinction by exempting from the registration procedure transactions which are not customarily a part of the distribution process, that is, transactions in which neither an issuer, an underwriter, nor a dealer (selling during the period of distribution) takes part. But the section does not, and was not intended to,[4] grant an exemption to any person performing an essential function in the distribution of securities by an issuer.

The activities of the petitioner here, as the court below held (R. 51), are plainly an integral part of a transaction by an issuer. A new issue of bonds is being sold to residents of the United States.

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[3] The Securities Exchange Act of 1934 regulates trading in securities as distinguished from the distribution of securities.

[4] The House Report on the bill which became the Securities Act of 1933 states the following with respect to Section 4 (1): "Paragraph (1) broadly draws the line between *distribution* of securities and *trading* in securities, indicating that the Act is, in the main, concerned with the problem of distribution as distinguished from trading." (Italics supplied.) H. Rpt. No. 85, 73d Cong., 1st sess., p. 15.

Petitioner, although it is not in a contractual relationship with the issuer and is motivated by patriotism rather than profit, is nonetheless the active party soliciting purchases in this country. The purchase price is transmitted to the Republic of China, the issuer. There is no separate and distinct transaction carried through by the petitioner: its solicitation merely initiates a transaction to be completed by the Republic of China. Since each completed transaction is one effected by an issuer, the transaction is not exempt under Section 4 (1).

(b) The second reason why no exemption is available under Section 4 (1) is that petitioner is in the position of an underwriter as defined by the Act. Section 2 (11) defines "underwriter," in part, as any person who "sells for an issuer in connection with the distribution of any security * * *." As pointed out above, petitioner clearly "sells" Chinese bonds within the meaning of the statute because it solicits offers to buy these securities. It is also clear that petitioner solicits these offers to buy for the benefit of the issuer: it has collected over $600,000 in subscriptions and has transmitted this amount to China for the purchase of bonds (R. 1).

Petitioner contends, however, that it is not selling "for an issuer," even though it may be selling for the benefit of an issuer, because it has no contractual or agency relationship with the Republic of China (Pet. 16–18). This contention miscon-

ceives the nature of the Securities Act. The aim of the statute is to have information available for investors before any securities may be distributed to residents of the United States. The exact nature of the relationship between the issuer and the person who solicits the offers to buy the securities is immaterial to the purposes of the Act; investors need the information afforded them by the registration procedure quite as much when the person who "sells" them the security is a volunteer rendering services for the issuer out of motives of patriotism, as when the person is a commercial underwriting firm, acting for profit under a contractual relationship with the issuer. In either case, the person is an "underwriter" because it is by means of his solicitation of offers to buy that a distribution of securities by the issuer is effected.

3. There is no merit in petitioner's suggestion that, even if the Commission is entitled to relief, resort should be had to diplomatic intervention rather than to the injunctive process (Pet. 23). Congress designated a method by which the Commission may put a halt to violations of the Act: in Section 20 (b) it authorized the Commission to seek an injunction in the courts. It designated this remedy despite the fact that the Act is specifically applicable to securities issued by a foreign government. Petitioner advances no reason why the remedy provided by Congress should not be available in the circumstances of this case

4. The identical questions presented in this case were presented in five similar proceedings brought by the Commission against other Chinese organizations engaged in selling in this country Liberty Bonds and U. S. Dollar Bonds of the Chinese Government. In all of these cases, consent injunctions were obtained.[5] In one other case the Commission obtained a consent injunction against a patriotic bond subscription society selling Japanese bonds in Hawaii by substantially the same methods as those employed by petitioner.[6] No other similar cases are now pending.

5. The Commission wishes to emphasize, as it did in the courts below, that its action in instituting the present proceeding was not motivated by a desire to prevent the sale of Chinese securities in the United States. The Commission has, of course,

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[5] *Securities and Exchange Commission* v. *Chinese Patriotic Society and Chinese Consolidated Benevolent Association of Fresno, Chinese Relief and Refugee Association*, Civil Action, File No. 643RJ (S. D. Cal., Nov. 2, 1939); *Securities and Exchange Commission* v. *Chinese Benevolent Association of Philadelphia*, Civil Action, File No. 786 (E. D. Pa., March 4, 1940); *Securities and Exchange Commission* v. *The China Society*, Civil Action No. 220 (D. Ore., Oct. 30, 1939); *Securities and Exchange Commission* v. *China War Relief Association of America et al.*, Civil Action, File No. 21404R (N. D. Cal., Nov. 3, 1939); *Securities and Exchange Commission* v. *The Seattle Chinese Patriotic League*, Civil Action, File No. 116 (W. D. Wash., Oct. 23, 1939).

[6] *Securities and Exchange Commission* v. *Patriotic Bond Subscription Society of Hawaii, and Kango Kawasaki, et al.*, Equity No. 733 (D. Hawaii, Jan. 20, 1939).

no reason to object to the sale of such securities if they are registered in accordance with the provisions of the Securities Act; in fact, upon proper representations, the Commission would undoubtedly exercise its full discretion to expedite such registration. It is plain, however, that the Commission cannot ignore petitioner's obvious violation of the Act without opening the way for violations by other persons with less worthy motives.

CONCLUSION

It is respectfully submitted that petition for a writ of certiorari should be denied.

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SEPTEMBER 1941.

APPENDIX

Sections 2 (2), (3), (11), 4 (1), 5, and 20 (b) of the Securities Act of 1933, 48 Stat. 74, as amended (15 U. S. C. Secs. 77b (2), (3), (11), 77d (1), 77e, and 77t (b)), provide as follows:

SEC. 2. When used in this title, unless the context otherwise requires—

* * * * *

(2) The term "person" means an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organization, or a government or political subdivision thereof. As used in this paragraph the term "trust" shall include only a trust where the interest or interests of the beneficiary or beneficiaries are evidenced by a security.

(3) The term "sale," "sell," "offer to sell," or "offer for sale" shall include every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value; except that such terms shall not include preliminary negotiations or agreements between an issuer and any underwriter. Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing, shall be conclusively presumed to constitute a part of the subject of such purchase and to have been sold for value. The issue or transfer of a right or privilege, when originally issued or transferred with

a security, giving the holder of such security the right to convert such security into another security of the same issuer or of another person, or giving a right to subscribe to another security of the same issuer or of another person, which right cannot be exercised until some future date, shall not be deemed to be a sale of such other security; but the issue or transfer of such other security upon the exercise of such right of conversion or subscription shall be deemed a sale of such other security.

* * * * *

(11) The term "underwriter" means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

* * * * *

SEC. 4. The provisions of section 5 shall not apply to any of the following transactions:

(1) Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not with or through an

underwriter and not involving any public offering; or transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except transactions within one year after the last date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter (excluding in the computation of such year any time during which a stop order issued under section 8 is in effect as to the security), and except transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

* * * * *

SEC. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to

any security registered under this title, unless such prospectus meets the requirements of section 10; or

(2) to carry or to cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of section 10.

* * * * *

SEC. 20. * * *

(b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States, United States court of any Territory, or the Supreme Court of the District of Columbia to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this title. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of begins, or in the district wherein such prospectus or security is received.

* * * * *

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